UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
SIXTH DIVISION

In Re: Lynn N. Schirmer d/b/a Vern & Lynn's Food Center/Lynn's Food Center and Ellen M. Schirmer, Debtors.	CHAPTER 7 Bky. Case No. 94-60250
Kip M. Kaler, Trustee of the Bankruptcy Estate of Lynn N. Schirmer d/b/a Vern & Lynn's Food Center/Lynn's Food Center and Ellen M. Schirmer, Plaintiff, vs. Nash Finch Company, Defendant.	Adv. Case No. 96-6028 ORDER GRANTING SUMMARY JUDGMENT

This matter is before the Court on motion of Defendant Nash Finch Company for summary judgment in this action brought by Kip M. Kaler, as Trustee of the Bankruptcy Estate of Lynn N. Schirmer d/b/a Vern & Lynn's Food Center/Lynn's Food Center and Ellen M. Schirmer. The motion was heard on January 30, 1997; appearances are as noted in the record at the hearing; and, the Court now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
FACTS

Lynn N. Schirmer d/b/a/ Vern & Lynn's Food Center/Lynn's Food Center and Ellen M. Schirmer [hereinafter "Debtors"] filed a Chapter 7 bankruptcy petition on May 10, 1994. Kip M. Kaler [hereinafter "trustee"] was appointed bankruptcy trustee in the case. The Debtors owned and operated Vern and Lynn's Food Center, Inc. [hereinafter "store"], a grocery store located in Detroit Lakes, Minnesota. Defendant Nash Finch Company [hereinafter "Defendant"] is a grocery wholesaler headquartered in Minneapolis, Minnesota.

In 1986, the Debtors became partners with Mr. and Mrs. Vern Seal in a store then known as Vern & Lynn's Food Center. The Defendant first became involved with the Debtors in 1990 as the store was emerging from a Chapter 11 bankruptcy filed in 1988.

As part of the store's Chapter 11 bankruptcy plan, the Defendant agreed to become the store's wholesale grocery supplier and to serve as a guarantor on $210,000 of a loan from First American Bank [hereinafter "Bank"]. The Bank's loan was secured by a blanket security interest in all personal property of the partnership, including inventory, equipment, accounts, general intangibles, and an assignment of the sublease for the store premises, together with all proceeds.

On May 22, 1992, the Debtors and the Seals incorporated the business as Vern & Lynn's Food Center, Inc. by filing articles of incorporation with the Secretary of State of Minnesota. In June of 1992, the Defendant bought the Bank's loan after the Bank demanded payment from the corporation. The Defendant simultaneously loaned the corporation an additional $100,000. At this time the Defendant became more involved with the store's operations. First, the Defendant directed the Schirmers to use $20,000 of the $100,000 loan to buy the Seal's interest in the store, making each Debtor a 50% shareholder in the store. Second, the store participated in the Defendant's accounting, check writing, and central billing services. The Defendant also made recommendations regarding the termination of certain employees, as well as scheduling and payroll changes. Both parties appear to agree that the buyout and the participation in financial programs were conditions of the loan agreement.

The parties disagree, however, as to who had the ultimate decision making authority with respect to writing checks. The trustee contends that Dick Rennich, an employee of the Defendant, had the final determination of what checks were written and what bills were paid. The Defendant contends that the Debtors retained full authority over the finances of the store and decided which bills to pay.

The parties also disagree with respect to who decided which vendors to use and which products to buy. The trustee states that the Defendant told the Debtors not to use Kemps as a dairy products supplier. The Defendant states that the Debtors had all authority to make decisions regarding inventory purchasing, including the selection of vendors and the products purchased.

Under the financial arrangement between the store and the Defendant, the Defendant was always paid first, including its bill for products provided to the store, its bill for the central billing payments, and its fees for participation in the Defendant's various financial services.

In March of 1993, the store bounced a check for products provided by the Defendant. This check was written by the Defendant as part of the check writing service. This failure to pay constituted a default under the security agreements and a breach of the Retail Sales Agreement, and the store was placed on C.O.D. terms with the Defendant.

Subsequently, representatives of the Defendant approached Lynn Schirmer and requested that he turn over the store to them. Mr. Schirmer indicated that he did not wish to do so until after he had consulted with his attorney. The representatives did not pursue the issue further. A series of events occurred in early 1994 resulting in the ultimate transfer of the store's assets to the Defendant on March 24, 1994. While the Debtors were out of town, the store was again unable to pay for products it ordered from the Defendant. As a result, the Defendant discontinued central billing. Thereafter, many of the store's vendors would only sell products to the store on a C.O.D. basis. The store's cash flow was so poor, however, that it was unable to successfully do business on C.O.D. terms. The Debtors voluntarily transferred the store's assets to the Defendant on March 24, 1994 in full satisfaction of its debts owed to the Defendant. The Debtors did not sign the transfer documents prepared by the Defendant.

Both parties agree that the debt owed to the defendant on March 24, 1994 was $407,724. At the time of transfer, an inventory was conducted at the request of the Defendant by RGIS Inventory Specialists. RGIS placed a cost value of $162,299.19 on the inventory. Cash on hand totaled $3,496, collectible accounts receivable totaled $4,677.93, and supplies totaled $2,932.67. The net price received for the equipment at a public auction was $68,378.12. The Defendant contends that total value of the collateral transferred to the Defendant was $241,783.91. The trustee debates this figure and argues that the value of the assets was $520,000, less any reduction in inventory. That figure represents the stated balance sheet value of the store in October of 1993, which contained an amount attributed to goodwill.

II.
THE ACTION

The trustee commenced this action against the Defendant, seeking to recover the store assets (or their value) transferred to the Defendant on March 24, 1994. The trustee brings three causes of action pleaded as alternative means to recover the assets. First, the trustee seeks turnover of the assets pursuant to 11 U.S.C. Section 542. Second, the trustee seeks to subordinate any claims of the Defendant to those of general unsecured creditors pursuant to 11 U.S.C. Section 510 and to recover the assets as a preference pursuant to 11 U.S.C. Section 547. Third, the trustee seeks to recover the assets as a fraudulent transfer pursuant to 11 U.S.C. Section 548. The trustee primarily discusses the second of these causes of action as the means to recover the assets, arguing that the Defendant's involvement in the store's operations amounted to inequitable conduct worthy of equitable subordination.

The Defendant made a motion for summary judgment with respect to all three causes of action brought by the trustee. The Defendant argues that turnover is inappropriate for three reasons: 1) the store assets were the property of the corporation and not of the Debtors; 2) any interest in the store assets was surrendered to the Defendant pre-petition, and; 3) the trustee is not entitled to turnover unless adequate protection of the Defendant's interests is provided.

The Defendant argues that equitable subordination is inappropriate for four reasons: 1) the store assets were the property of the corporation and not of the Debtors; 2) the Defendant no longer holds any claim that could be subordinated; 3) all actions taken by the Defendant were simply exercises of the rights and the remedies afforded to the Defendant under its loan documents, and; 4) the actions taken by the Defendant do not rise to the level of control necessary to justify equitable subordination.

The Defendant argues that the doctrine of fraudulent transfer does not apply for three reasons: 1) the store assets were the property of the corporation and not of the Debtors; 2) there is no evidence that the Debtors intended to hinder, delay or defraud creditors, and; 3) the value of the assets was less that the debt owed to the Defendant.

III.
DISCUSSION

A) Summary Judgment

According to Rule 7056(c), F.R. Bankr.P., summary judgment is required where:

> [the] pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any show, that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.

The moving party bears the burden of demonstrating the absence of a genuine issue of material fact. Adickes v. S.H. Kress and Co., 398 U.S. 144, 157 (1970). A defendant can meet the burden by demonstrating the absence of evidence to support the plaintiff's case on which the plaintiff would have the burden of proof at trial. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). But, such a review of evidence assumes initial viability of the underlying pleaded cause of action against which the evidence is to be measured. Here, the trustee has failed to plead viable causes of action; and, as a matter of law, Defendant is entitled to summary judgment for that reason.

B) Parameters of The Trustee's Rights of Action

A trustee is only entitled to recover, by means of turnover, preference, or fraudulent transfer, property in which the debtor had an interest at filing of a bankruptcy case, and only to the extent of such interest. Section 542(a) of the Bankruptcy

Code governing turnover provides:

> . . . [A]n entity, other than a custodian in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Section 363 only permits the trustee to use, sell or lease "property of the estate." Property of the estate is defined by section 541(a)(1) of the Bankruptcy Code as "all legal or equitable interests of the debtor in property as of the commencement of the case." (emphasis added).

Section 547(b) of the Bankruptcy Code governing preferences begins: "Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--". (emphasis added). Similarly, section 548(a) of the Bankruptcy Code governing fraudulent transfer begins: "The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition. . ." (emphasis added).

For the trustee to have a viable cause of action to recover the store's assets transferred to the Defendant, the Debtors must have had a prepetition interest in the assets. If the assets were owned by the Debtors, either because they were owned individually and had not been transferred to the corporation; or, because the corporation and the Debtors can be considered one entity; then, the assets are potentially recoverable for the estate by the trustee. If, however, the assets were separately owned by the corporation, the assets could not be property of the Debtors' estate; rather, they were property of the nondebtor corporation which is separate and distinct from its shareholders (the Debtors). The trustee, therefore, would have no bankruptcy causes of action to recover the assets from the Defendant.

C) Ownership of Assets

1. In General

In In re Newman, the Eighth Circuit Court of Appeals stated that a partnership is generally recognized as a separate and distinct entity from its partners. 875 F.2d 668, 670 (1988). "'Where the debtor is a member of a partnership, the debtor's interest in the partnership is included in the estate. However, assets held by the partnership itself are not included in the estate.'" Id., citation omitted.

The Fourth Circuit Court of Appeals has long since addressed the ownership of assets of closely held corporations in Wilson v. Williams Hardware Co., in which it stated:

> there is a difference between owning stock in a corporation and owning its assets. The latter do not pass to the trustee in bankruptcy of a stockholder, even if he be the sole stockholder; for, even though an individual acquire all of the stock of a corporation, he and the corporation are not one and the same, but are distinct and separate legal entities and must be so treated.

32 F.2d 103, 104-105 (1929).

At least one bankruptcy court in the Eighth Circuit has similarly ruled in a more recent decision. The United states Bankruptcy Court for the Western District of Arkansas held that:

> The trustee's argument that the estate has an equitable interest in the [corporate] funds solely by virtue of 82% stock ownership is also without merit. A corporation has a separate legal existence from its shareholders, and the corporation, not its shareholders, owns the corporate assets and owes the corporate debts.

Russell v. Streetman, 121 B.R. 16, 17 (W.D. Ar.1990)

The nature and extent of shareholder interest in corporate assets are determined by the relevant state law. The Minnesota Supreme Court has consistently treated ownership of corporate assets similar to the above cases. Whitney v. Leighton, 30 N.W.2d 329, 333 (1947) ("In the absence of fraud, the corporation must be treated as a legal entity separate and apart from its stockholders."); Corcoran v. P.G. Corcoran Company, 71 N.W.2d 787, 795 (1955) ("The basic theory of corporation law is that a corporation exists as an entity entirely separate and apart from its shareholders."); Di Re v. Central Livestock Order Buying Company, 74 N.W.2d 518, 523 (1956) ("A corporation is an artificial person, created by law, or under authority of law, as a distinct legal entity, with rights and liabilities which are independent from those of the natural persons composing the corporation."); Milwaukee Motor Transp. Company v. Commissioner of Taxation, 193 N.W.2d 605, 608 (1971) ("It is well settled that a corporation possesses a legal existence separate from its stockholders. It owns its own property, and it must answer for its own contractual and tort obligations.").

The court has not found any reported Minnesota case that makes an exception to these basic corporate principles for closely held corporations. Accordingly, in Minnesota, even a corporation, the stock of which is solely owned by one or two persons, is apparently considered a separate and distinct entity from its shareholders; absent creation and use of the corporation as a fraudulent device.

2. Assets In this case

In his Supplemental Memorandum of Law, the trustee argues that it is immaterial whether the assets were owned by the corporation or by the individual Debtors because, according to the trustee, the corporation is not a separate and distinct entity from the individual Debtors. As support for this contention, the trustee notes that many of the creditors looking to the Debtors for payment are in fact creditors that provided products and services to the corporation, not to the Debtors as individuals. The trustee states that the Defendant is the only creditor that knew the store was a corporation. The trustee further argues that "[t]he corporation created by the debtors was a mere facade, having no actual purpose in practice as between Mr. and Mrs. Schirmer and the creditors of the business operations." Plaintiff's Supplemental Memorandum of Law, page 7, Feb. 14, 1997.

The trustee primarily relies on In re Beshears as support for his argument. 196 B.R. 464 (E.D.Ar. action seeking to avoid the post-petition transfer of corporately owned land by a corporation in which the debtor-husband had been a 50% shareholder prepetition. At bankruptcy filing, the debtor held 50% of the shares of a corporation named Al & Beck, Inc., and held an option to purchase the other 50%. Shortly after filing a Chapter 7 bankruptcy petition, the debtor Beshears, entered an agreement with an individual named Coleman, wherein he agreed to transfer his 50% interest in Al & Beck to Coleman in exchange for $40,000 cash(F1). The money was needed to exercise the option for the other 50% interest in the corporation, which option was to expire the next day. As part of the deal, Beshears, who was president of Al & Beck, agreed to cause the corporation to convey the land, which was the corporation's sole asset, to Coleman or his nominee. Beshears used the $40,000 he received for the purported transfer of his prepetition shares to exercise the option to acquire the remaining shares; and, as president of the corporation, conveyed the land to a partnership named Coleman Farms Partnership.(F2) Apparently, consideration for the transfer was the assumption by Coleman Farms of a mortgage against the property.

The bankruptcy court avoided the transfer, stating that "[i]f the effect is to defraud the creditors, the transfer should be avoided." Id. at 467. The court recognized that the trustee had an interest in the corporate stock, but no direct interest in the corporate assets. The court explained, however, that the value of the stock, and thus the value to the bankruptcy estate, was inextricably tied to the value of the corporation's assets. The court found that the transfer made by the debtor reduced the value of the bankruptcy estate's gross interest from $641,750 to zero and stated "[o]nce the land was transferred, the bankruptcy estate was depleted by the value of that asset." Id.(F3)

In Beshears, there was substantial evidence that the transfer of the corporate land was part of a larger scheme by the debtors and others to intentionally defraud the debtors' creditors, and eventually their bankruptcy estate itself. Nine months prior the Beshears decision, the same bankruptcy court set aside a pre-petition transfer of a home from the debtor-wife to her parents as a fraudulent transfer. In re Beshears, 182 B.R. 235 (E.D.Ar. 1995). One month after the Beshears decision, the court denied the debtor-husband's bankruptcy discharge in part for concealment and transfer of property with intent to defraud creditors. In re Beshears, 196 B.R. 468 (E.D.Ar. 1996).

Unlike Beshears, there is no evidence of a scheme to defraud the Debtors' creditors in this case, by the Debtors or anyone else. While the Beshears holding might have been appropriate in that case, given its unique facts, the holding has no application here. The Plaintiff trustee has no bankruptcy interest in assets of Vern and Lynn's Food Center, Inc., a corporation in which the Debtors were sole shareholders. Accordingly, whether the assets were corporately owned, bears heavily on viability of the trustee's action.

The trustee argues, in his Response to Motion for Summary Judgment, that the partnership assets were never transferred to the corporation.(F4) The only support for this contention is the statement by one of the Debtors that "[w]e never transferred the assets of the partnership to the corporation, although we may have intended to." The statement was made by Lynn Schirmer in an affidavit. Affidavit of Lynn N. Schirmer, page 1, Jan. 17, 1997.

The Defendant contends that the assets and liabilities of the partnership were transferred to the corporation at the time of incorporation, and therefore, were assets of the nondebtor corporation and not of the Debtors. The Defendant cites to the Debtors' individual, partnership, and corporate tax returns as support for this contention.

Evidence provided by the parties shows that the assets of the partnership were transferred to the corporation. Schedule L of the tax returns of the partnership for 1991 and the short year ending September 26, 1992, list the store assets as the assets of the partnership. Schedule L of the tax returns for the corporation for the short year commencing on September 27, 1992 and for 1993 list the same store assets as assets of the corporation. The store assets reported at the end of the tax year on partnership Schedule L are the identical assets reported at the beginning of the tax year on the corporate Schedule L. For example, the inventory amount reported at the end of tax year on the partnership tax return is $258,889. The same inventory amount is reported at the beginning of the tax year on the corporate tax return. Buildings and other depreciable assets are reported at the end of the tax year on the partnership tax return as amounting to $440,416. The same amount is reported for the same assets at the beginning of the year on the corporate tax return. Furthermore, the debtors' individual tax returns do not list the store assets as assets of the debtors. The trustee has pointed to no evidence in the record that raises an issue of material fact concerning the matter.

Based on the foregoing analysis, this Court finds that the store assets transferred to the Defendant on March 24, 1994, were assets of the corporation and not of the individual Debtors. The Court holds that the trustee, therefore, has no bankruptcy cause of action to recover the assets, or their value, from the Defendant. Accordingly, Defendant Nash Finch Company is entitled to summary judgment.

IV.
DISPOSITION

Based on the foregoing, it is hereby ORDERED that Defendant Nash Finch Company be granted summary judgment.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: April 18, 1997 By The Court:

Dennis D. O'Brien
Chief U.S. Bankruptcy Judge

(1). Of course, Beshears prepetition shares belonged to the trustee, but Beshears agreed to, and purportedly did, transfer the shares anyway. So did the option to acquire the other 50% belong to the estate, but again, Beshears exercised the option in his own name. Apparently, the trustee was unaware of the corporation and Beshears' interest in it at the time of these transfers. Coleman was aware of the bankruptcy.

(2). The record does not reflect whether Beshears held an interest in Colman Farms. Presumably, he did.

(3). The bankruptcy court found that the land was valued at $681,750 at the time of transfer. There existed a mortgage on the property in the amount of $507,755.61. Equity in the land was $173,994.39. Lost opportunity to the estate was $133,994.39, which is the difference between the $173,994.39 equity and the $40,000 needed to acquire the other 50% of the corporation by exercising the option.

(4). Ownership by the partnership could not give viability to the trustee's action, since the partnership assets would not be included in the estate either. In re Newman, 875 F.2d 668, 670 (8th Cir. 1988).